

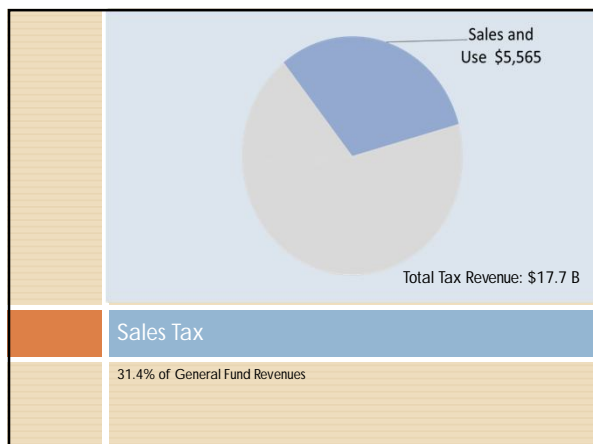
AN OVERVIEW OF SALES AND USE TAX

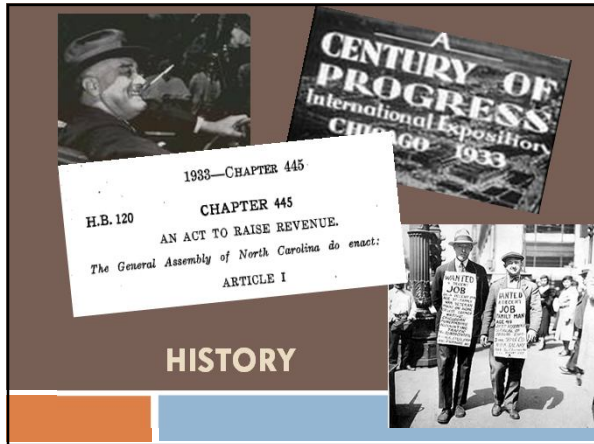
Joint House and Senate Finance, February 9, 2011

Trina Griffin & Sandra Johnson

Outline

- History
- Sales Tax Basics: Use Tax, Nexus, Streamlined
- Rates: General, Combined General, Preferential
- Exemptions & Refunds
- Tax Reform Proposals





History

- Created in 1933 as temporary tax to meet a “supreme emergency”; made permanent in 1939.
- 3% on tangible personal property
- Exemptions:
 - Sales to Federal or State governments.
 - “Primary and essential articles of food”
 - Items taxed under another statute
 - Public school books
 - Certain sales of farm, mineral, and forest products.
- Gross receipts tax on amusements enacted in 1933 at same rate as retail sales of merchandise – 3%

That Was Then...

1940-1950	1951-1960	1961-1970	1971-1980
Exempt food Exempt prescription drugs Exempt fuel sold to farmers	Expanded tax to lodging Exemptions expanded 1%/\$80 cap on motor vehicles & airplanes	1%/\$80 cap on mill machinery Food exemption repealed	1¢ local sales tax authorization

That Was Then...

1981-1990	1991-2000	2001-Present
<ul style="list-style-type: none"> Merchants discount repealed Highway use tax on vehicles Two ½¢ local sales tax authorizations Exempt food purchased with food stamps Sales tax on utilities 	<ul style="list-style-type: none"> 1st rate increase since enactment – 4% Exempt food Use of exemptions & refunds as economic devpt. 	<ul style="list-style-type: none"> Streamlined Third ½¢ local sales tax Rate increases Sales tax holidays Video programming Medicaid swap Digital products

This Is Now

<ul style="list-style-type: none"> 45 states and the District of Columbia have sales tax. 33 states allow localities to charge a local sales tax. Combined state and local rates range from 4.35% (Hawaii) to 9.44% (Tennessee). Consumption tax; shrinking base due to shift in consumer's spending patterns. Sales tax more stable than income tax but sale of durable goods more volatile than services.
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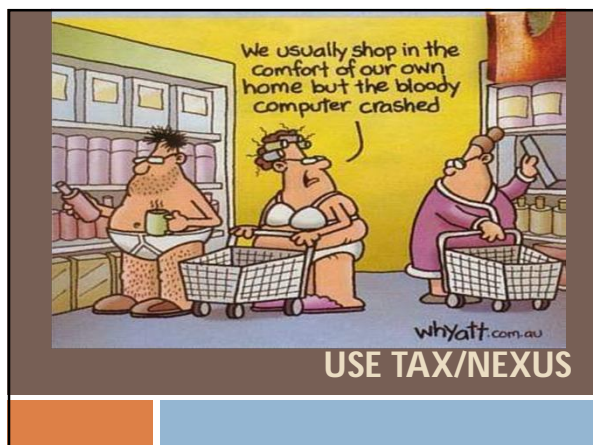
Shift in Consumption

	1979 Percent	2007 Percent
Total Expenditures	100.0	100.0
Durable Goods	13.4	11.1
Nondurable Goods	39.1	29.2
Services	47.4	59.7

Source: Dr. Roby Sawyers, NC State University, "Principles of Sound Tax Policy – How Does the NC Sales Tax Measure Up?" November 17, 2009.

Services Currently Taxed in NC

- Certain Utilities
 - ▣ Telecommunications
 - ▣ Electricity
 - ▣ Heating Oil
- Video Programming
 - ▣ Cable TV
 - ▣ Direct Satellite TV
- Personal Services
 - ▣ Laundry & dry cleaning
 - ▣ Diaper service
 - ▣ 900 numbers
 - ▣ Tuxedo rental
- Business Services
 - ▣ Graphic design
 - ▣ Photocopying & Printing
 - ▣ Photo finishing



Use Tax

- A tax on tangible personal property, digital property, and certain services purchased outside the State for use, storage, or consumption in the State.
- Paid by purchaser when sales tax has not been collected by the seller.
- Reported annually on income tax return.
- Undercollected because of lack of effective enforcement.

Nexus

- *Quill Corporation v. North Dakota* (1992)
- A retailer must have a physical presence in the State to be required to collect NC sales tax.
- Amazon "click-through" legislation
- Internet Transactions Resolution Program

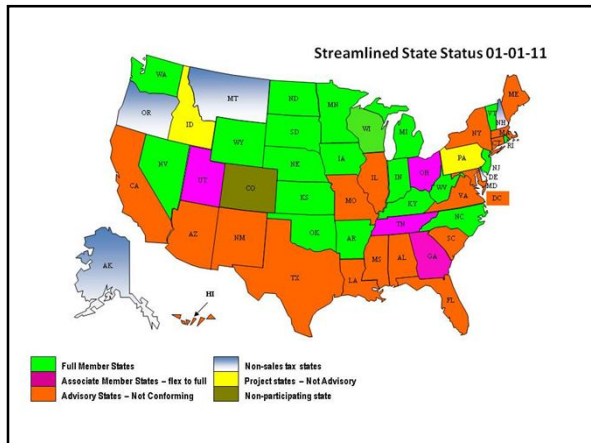
E-Commerce in NC

- How much is out there in uncollected sales tax from e-commerce?
 - Univ. of TN study estimates that \$138.6 million
 - Focuses on B2B transactions as well as B2C
 - Estimates assume that only large retailers currently comply.
 - Fiscal Research estimates that \$20.6 million in State
 - Focuses only on retail transactions.
 - Assumes current compliance by 65% of retailers.

STREAMLINED SALES TAX AGREEMENT

Streamlined Sales Tax Agreement

- Created in 1999.
- Voluntary, cooperative effort of states, the District of Columbia, local governments, and the business community to simplify and modernize sales and use tax collection and administration.
- 24 of 44 states with a sales tax have passed conforming legislation (20 full members, including North Carolina; 4 associate members).
- NC became a member of the Agreement October 1, 2005.
- Collection of over \$46.5 million through voluntary compliance since joining.



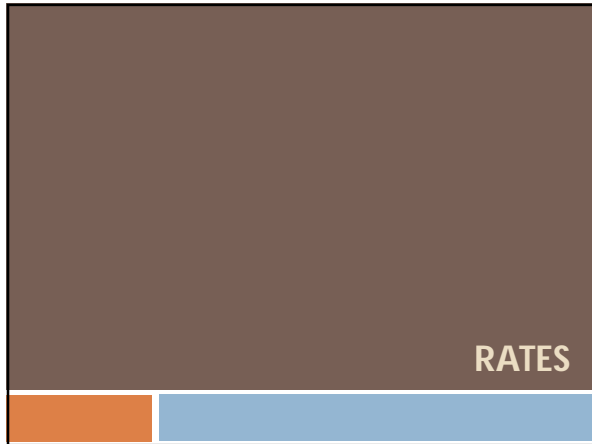
Simplification

Uniformity

- Uniform State and local base
- One State rate, with some exceptions
- One rate per local jurisdiction
- No caps or thresholds

Administration

- State-level administration of tax
- State responsible for electronic, downloadable databases of jurisdiction boundaries and tax rates
- Central, electronic registration for all states
- Simple electronic return and electronic payment



General Rate

- The general **State rate** of tax is 5.75%. The temporary 1% increase enacted last year is scheduled to expire July 1, 2011 (\$1.0 B).
- Items that are subject to State sales tax are also subject to the local sales and use tax. The **local rate** of tax varies:

2% (82)	2.25% (18)	2.5% (1)
All other 82 counties	Alexander Catawba Cumberland Duplin Halifax Haywood Hertford Lee Martin	New Hanover Onslow Pitt Randolph Robeson Rowan Sampson Surry Wilkes
		Mecklenburg

State Rate Changes



"Combined General Rate"

□ What is it?

- Defined term enacted in S.L. 2005-276.
- Not the same as general rate of State and local tax
- State's general rate (5.75%) + sum of rates of local sales tax authorized for every county (2.25%)*
- Current combined general rate = 8%

□ What is subject to the combined general rate?

- Spirituous liquor – State only
- Telecommunications – shared with locals
- Video Programming – shared with locals

*Not necessarily the rate levied in every county.

Preferential Rates

Item	Rate	Cap?
Manufactured Homes	2%	\$300
Modular Homes	2.5%	No
Aircraft & boats	3%	\$1,500
Electricity	Varies based on purchaser	No
Certain M&E*	1%	\$80

Electricity

- The rate varies depending on the purchaser of electricity and the purpose for which it is used.

□ Sold to:

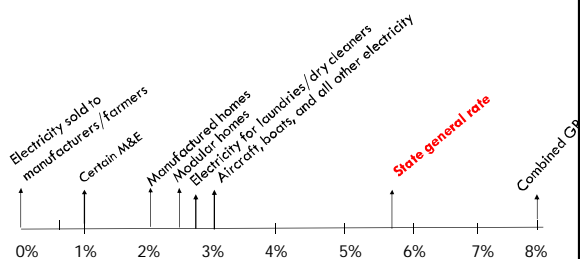
- Manufacturers and farmers EXEMPT*
- Commercial laundry or dry cleaners 2.83%
- Commercial businesses and residences 3%

*Effective July 1, 2010.

Excise Tax on Machinery

- Prior to 2001 – 1% sales tax/\$80 cap on mill machinery
- In 2001, sales tax replaced with privilege tax at same rate to conform to Streamlined.
- Since then, eligible M&E expanded to include:
 - ▣ Major recycling facility
 - ▣ R&D company in physical, engineering, and life sciences
 - ▣ Software publishing
 - ▣ Industrial machinery refurbishing company
 - ▣ Datacenters

Range of Current State Rates



SELECT SALES TAX
EXEMPTIONS AND REFUNDS

History: Three Classes of Exemptions

- Subject to another tax or sound tax policy principle
 - ▣ Highway use tax, business inputs, etc.
- Serves as a governmental entity
 - ▣ Local government, Federal government
- Part of a public policy decision
 - ▣ Charitable organizations, food, chiropractor supplements



History

- 1933 – Exemptions included food, items sold to government, etc.
- 1941 – General Assembly added the first exemption relating to sales to religious or charitable institutions
- 1961 – Sales tax exemptions replaced with refunds
- 1995 – Refund expanded to “homes for the aged”
- 2005 – General Assembly repealed refunds for public schools, creating public school transfer

History

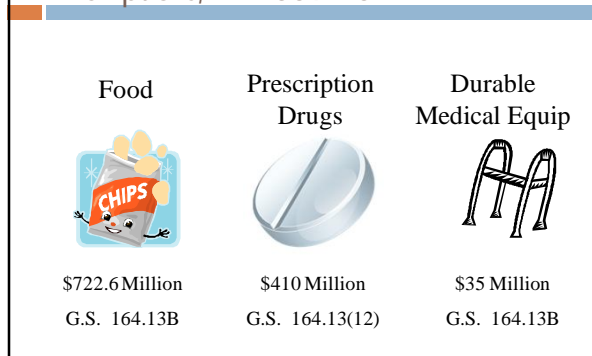
1951

- 32 sales tax exemptions
 - ▣ Sales to non-profit, religious, and charitable organizations
 - ▣ Sales of gasoline or other motor fuels
 - ▣ Public school books
 - ▣ Sales of mill machinery

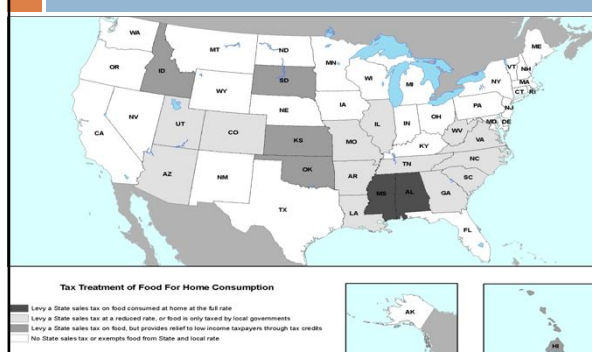
2011

- 59 sales tax exemptions
 - ▣ Supplements sold by chiropractors \$400K
 - ▣ Sales from vending machines \$11.4M
 - ▣ Newspapers sales made by street vendors \$7.5M
- 26 types of organizations eligible for sales tax refunds

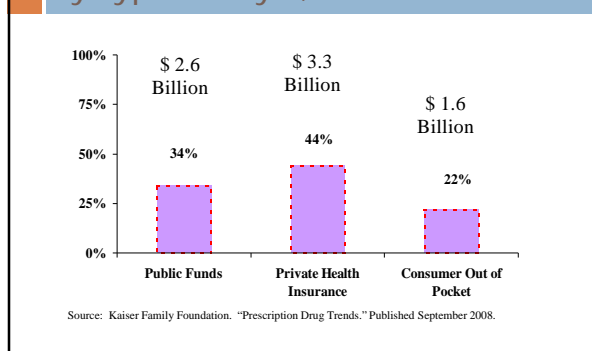
Three Major Sales and Use Tax Exemptions, FY 2009-10



History of the Sales and Use Tax and Food, 2010



Percent of Drug Expenditures, U.S. by Type of Payer, 2006



Organization Types Eligible for Sales Tax Refunds

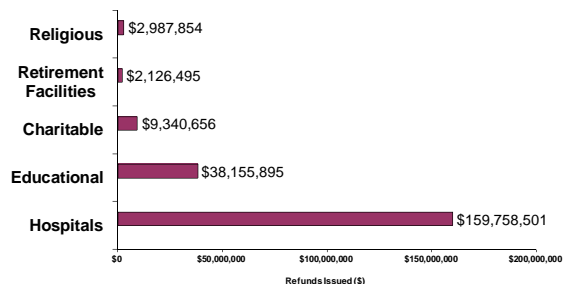
- Governmental agencies
- Religious and charitable
- Nonprofit hospitals
- Nonprofit educational institutions
- Qualifying continuing care and retirement communities

Government Refunds

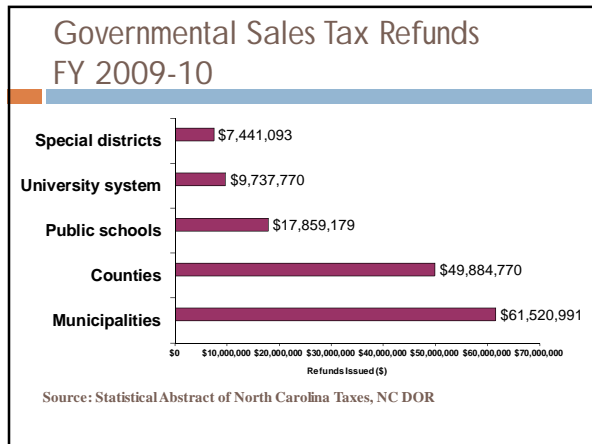
- Sub-state governments
 - ▣ Counties
 - ▣ Municipalities
 - ▣ Special districts
 - ▣ Public schools



Nonprofit Sales Tax Refunds > \$100K, FY 2009-10



Source: Statistical Abstract of North Carolina Taxes, NC DOR





- ### Tax Reform Proposals
- Eliminate preferential rates.
 - Eliminate/modify exemptions and refunds.
 - Transition certain "privilege" taxes to sales tax base (e.g. admissions, movies).
 - Broaden base to include more personal services/lower the rate.

Contacts

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